ST 06-0135-GIL 07/11/2006 COMPUTER SOFTWARE

If transactions for the licensing of computer software meet all of the criteria provided in 86 III. Adm. Code 130.1935(a)(1), neither the transfer of the software nor the subsequent software updates will be subject to Retailers' Occupation Tax. See 86 III. Adm. Code 130.1935. (This is a GIL.)

July 11, 2006

Dear Xxxxx:

This letter is in response to your letter dated June 27, 2006, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 III. Adm. Code 1200.110. A general information letter is not a statement of Department policy and is not binding on the Department. See 2 III. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

I am writing in response to the General Information Letter dated April 13, 2006 (copy enclosed) which you sent to our office.

We have reviewed our Master Agreement and the requirements set out in 86 III. Adm. Code 130.1935(a)(1) and believe that our contract meets all of the criteria, and as such, should qualify as a license of software not subject to sales tax.

The first four criteria were not disputed in your letter, but I will review them here.

- A. It is evidenced by a written agreement signed by the licensor and the customer.
 - Both our company and the customer do sign our 'Master Agreement' prior to any shipment of the software.
- B. The agreement restricts the customer's duplication and use of the software.

Under clauses 2 and 3 of the Master Agreement, the customer must use the software for its own 'internal business needs' and may copy the software 'only in non-printed, machine readable form in whole or in part as necessary for Client's authorized use hereunder, including the making of back-up copies' (clause 3).

C. The agreement prohibits the customer from licensing, sublicensing or transferring the software to a third party.

Under clauses 2 and 3 of the Master Agreement, the customer 'shall not permit any third party to use the software or grant a sublicense for the use of the software' (clause 2).

D. The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, **or permitting the licensee to make and keep an archival copy**.

Under clause 3 the customer is allowed to make back-up copies, which we believe satisfies this requirement.

In your letter, the requirements of section E were viewed as not being met, with which determination we disagree because of the factors stated below:

E. The customer must destroy **or return all copies** of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

Under clause 2, the customer is granted a perpetual license that is valid 'unless and until terminated hereunder'. Under clause 23, termination will result only if the customer commits a breach of the agreement requirements. Upon the occurrence of a breach, the customer is required to 'immediately return the system and all copies of the software and third party software' to the company.

In your General Information Letter of April 13, 2006, you stated that our Master Agreement did not meet the criteria in section E because (1) 'the customer is not required to destroy or return all copies of the software at the end of the license period', and (2) because you 'found no evidence that the license agreement grants a perpetual license to the customer'.

As demonstrated above, clause 23 of the Master Agreement *does* require the customer to return all copies of the software in the event of a termination of the license, and, under clause 2, the customer *is* granted a perpetual license that will continue indefinitely unless and until the customer breaches the agreement.

Our fact pattern generally resembles that described in Illinois Private Letter Ruling ST 02-0001-PLR dated 1/14/2002, in which the contract stipulated that 'the agreement and license are perpetual unless terminated in which case the customer must cease using the software' and return or destroy all copies to the company. This contract was seen as meeting the criteria under section 130.1935(a)(1) and was deemed to be exempt from sales tax.

For these reasons we believe that the criteria under parts A through E of the section 130.1935(a)(1) requirements are met, and that the licenses granted under our Master Agreement are not subject to sales tax.

If your conclusion as to the taxability of the software differs from ours on interpreting the statute and other rulings made by the department, we would appreciate the opportunity to discuss the issues with you further.

I have enclosed a copy of our Master Agreement for you review.

If you have any questions regarding these documents, or would like to discuss them with me, please feel free to contact me.

DEPARTMENT'S RESPONSE:

Your initial request did not meet the criteria needed to issue a Private Letter ruling; therefore a general information letter was issued to aid you in making a determination of your tax liabilities. General information letters are not binding on the Department and are intended to direct taxpayers to the Department's regulations or other sources of information regarding the topic about which the taxpayer has inquired. Should you desire to obtain a Private Letter ruling, you must comply with all of the factors required under 2 III. Adm. Code 1200.110.

In general, if transactions for the licensing of computer software meet all of the criteria provided in 86 III. Adm. Code 130.1935(a)(1), neither the transfer of the software nor the subsequent software updates will be subject to Retailers' Occupation Tax.

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 III. Adm. Code 1200.110 (b).

Very truly yours,

Edwin E. Boggess Associate Counsel

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